UNITED
NATIONS

A

General Assembly

Distr.
GENERAL

A/48/345
9 September 1993

ORIGINAL: ENGLISH

Forty-eighth session
Item 93 of the provisional agenda*

EXTERNAL DEBT CRISIS AND DEVELOPMENT

The international debt strategy as of mid-1993

Report of the Secretary-General

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BACKGROUND

For more than 20 years, the international community, and the General Assembly in particular, have monitored the evolving external debt situation of developing countries.* The concern deepened when the external debt crisis erupted in the early 1980s. Indeed, the great majority of heads of State and Government and foreign ministers that addressed the fortieth session of the General Assembly expressed their profound concern about the negative impact of the crisis on the development process and on international stability. An item entitled "External debt crisis and development" was inscribed on the agenda of the forty-first session of the Assembly, and a series of Assembly discussions began, the most recent being at the forty-seventh session. The latter debate led to resolution 47/198 of 22 December 1992, in which the Assembly requested, inter alia, that the present report be prepared.

The discussions in the General Assembly have been effective in a number of senses. First, the Assembly was able to adopt several resolutions by consensus or by a vote that showed almost universal support. This reflected a broad recognition at the political level of the severity of the external debt situation of developing countries and a shared concern - especially important in the early years of debate when it was a breakthrough - that a strengthened international policy was needed to resolve the crisis. At the same time, the need was widely recognized for economic adjustment measures that would lead, with international support, to adequate and sustainable economic growth.

Secondly, the Assembly sought to play a constructive role in facilitating the strengthening of international cooperation, for example, by requesting the Secretary-General to undertake a series of consultations on the external debt crisis and development. This was done in a variety of forms, including private meetings with a group of eminent personalities and high officials of relevant bodies, appointment of a special representative to undertake international consultations and, in the related context of the United Nations Programme of Action for African Economic Recovery and Development 1986-1990, the establishment of the Advisory Group on Financial Flows to Africa.

The Assembly discussions were effective in a third way in that they formed a part of a broad set of international impulses for new policy departures in several international forums, including the Interim and Development Committees of the International Monetary Fund (IMF) and the World Bank and the United Nations Conference on Trade and Development (UNCTAD). As a result, international policy was strengthened on several fronts on several occasions and consequently the debt crisis of many countries has been ameliorated. Nevertheless, the debt crisis remains a potent policy issue for a great many developing countries and the need for a further strengthening of international policy measures is broadly recognized, although consensus and action have yet to be realized on some important issues. The work of the General Assembly in fully achieving the objectives it set out some years ago is thus not yet complete.

* See, for example, General Assembly resolutions 2807 (XXVI) of 14 December 1971, 3039 (XXVII) of 19 December 1972, 31/158 of 21 December 1976, 32/187 of 19 December 1977 and 33/159 of 20 December 1978.

I. CURRENT DEBT SITUATION OF DEVELOPING COUNTRIES

1. Many observers date the developing country debt crisis from August 1982, when Mexico had difficulty in raising additional funds from international banks and had to suspend its debt servicing. 1/ Mexico and some other debtor countries have since returned to the financial markets, although many other heavily indebted countries that also had to suspend their debt servicing at about that time have not. In addition, the low-income countries that also sank into debt crises, even while having relied mainly on official sources of funds, have yet to return to long-run debt-servicing obligations that lie within their debt-servicing capacity.

2. The debt crisis emerged as the culmination of roughly a decade of rapid increases in lending coinciding first with very low interest rates in real terms, as international inflation gathered steam, followed by an interest rate shock, as industrial countries began their economic correction process. For the energy-importing developing countries, the 1979-1981 jump in international oil prices added to balance-of-payments pressures, and the subsequent rapid slippage in oil and other commodity export prices added another set of external shocks by 1982, as international recession set in. Suddenly, the countries that banks had perceived as being very low credit risks were viewed as uncreditworthy and new lending dried up.

3. The following years saw a series of international attempts to deal with the debt crisis, first on the assumption that the developing countries were facing a liquidity shortage that would end as soon as the industrial countries emerged from recession and trade and commodity prices recovered. Official lending replaced some of the private funds and banks were pressured into extending new credits to help service their own loans through concerted debt-rescheduling operations. Debt levels thus continued to grow rapidly and debtor countries tried various strategies to stabilize and adjust their economies.

4. Meanwhile, the industrialized economies embarked on the longest economic recovery period in post-war history and trade burgeoned, but real interest rates stayed unusually high and the export earnings of most developing countries remained weak. Changes were clearly needed in the tradable goods sectors of developing countries, as well as in the realm of macroeconomic stabilization, and it began to be realized that the debt-servicing obligations of many countries had come to exceed what they could ever be expected to pay, i.e., that they had become insolvent.

5. When a private enterprise becomes insolvent, it is broken up and its assets are sold to pay as much of its debts as they will cover. Creditors take a loss on the rest. As sovereign debtors are not private entities, other means had to be developed to spread losses among the creditors, while bolstering the ability and supporting the resolve of the governments of heavily-indebted countries to take corrective policy measures. This led to the formulation of the international debt strategy, an evolving set of international policies that now incorporate debt and debt-service reduction, as well as new financial flows and adjustment cooperation. Statistical indicators and a review of policies for debt restructuring in the following section illustrate the substantial progress that has been achieved and the considerable work still remaining.

A. Indebtedness indicators

6. The total foreign debt of the developing countries that began the 1980s as net capital importers is growing again, albeit slowly, following a period between 1987 and 1989 when the level of debt remained at around $1.2 trillion (see table). 2/ As of the end of 1992, debt totalled $1.4 trillion. Two thirds of the increase in 1992 originated in Asia, which has been the major source of the increase in the overall debt of the developing countries for the past three years. During this period, total debt of the region grew 10.3 per cent per annum on average. Its total debt stock, which reached 38 per cent of the developing country total, surpassed the share accounted for by Latin America in 1991. The Latin American region, in contrast, has seen the total stock of its debt grow marginally during these three years, with an average per annum growth rate of 2.0 per cent. The long-term debt alone has increased even less, by only 1.1 per cent per annum on average during 1990-1992. While the external debt of Africa as a whole has also grown slowly (2.5 per cent a year during 1990-1992), that of sub-Saharan Africa has grown more rapidly (7.7 per cent annually). 3/ Although the debt of the subregion remains small in aggregate, accounting for just over 10 per cent of the total, it looms large in economic terms as the following indicators show.

Table. External debt of the capital-importing developing countries, 1982, 1987-1992 a/

(Billions of United States dollars)

	1982	1987	1988	1989	1990	1991	1992 b/
Africa, of which,	139	252	258	268	280	283	288
sub-Saharan region c/	57	112	115	122	138	144	152
Asia	236	391	394	402	445	489	539
Western hemisphere	354	474	456	451	463	470	478
Other	51	93	93	92	101	101	114
Total	781	1 209	1 201	1 213	1 288	1 344	1 419

Source: United Nations, World Economic Survey, 1993, table A.35.

a/ For definition of country groups, see World Economic Survey, 1993, pp. 203-204.

b/ Preliminary.

c/ Excluding Nigeria.

7. In spite of the increase in total debt, debt-burden indicators, which largely reflect debt-servicing capacity, have improved at the aggregate level (see figure 1). The ratio of external debt to gross national product (GNP) has come down to almost the level of 1982. The ratios of external debt to exports and debt service to exports are substantially lower than they were in 1982.

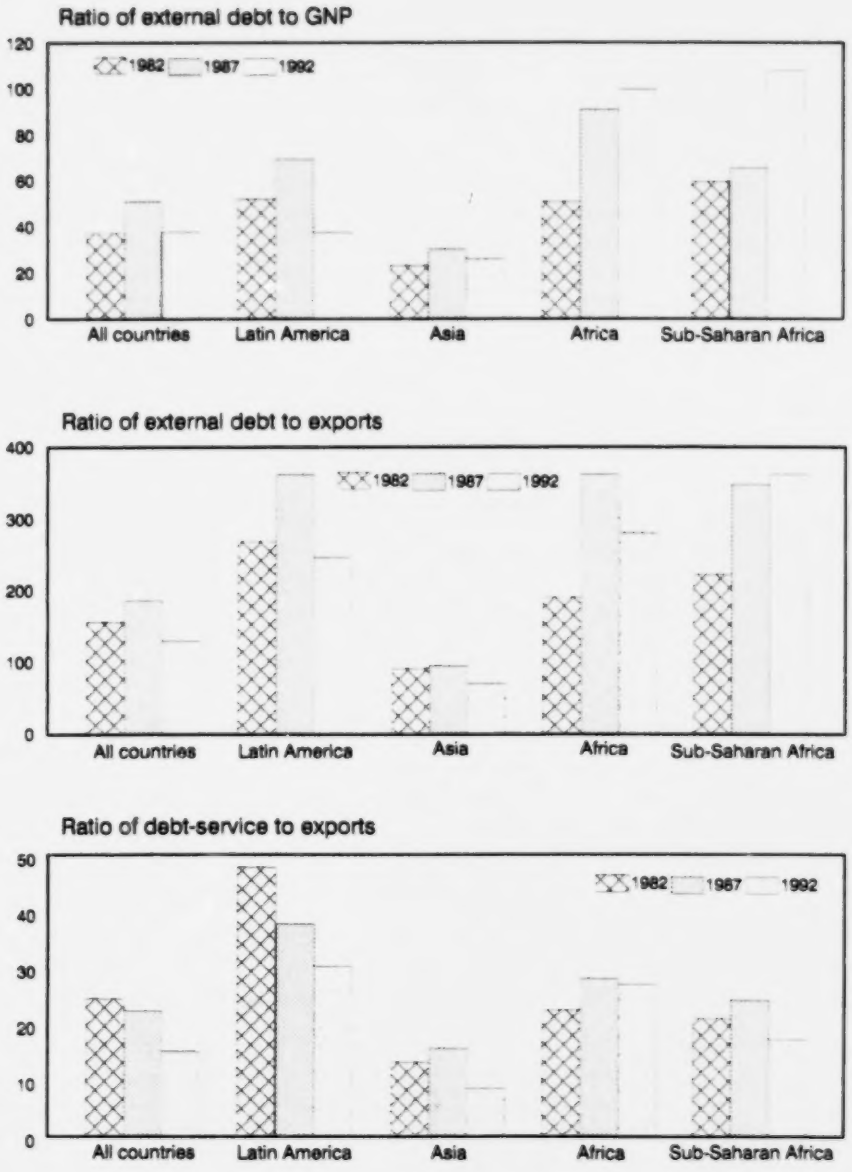
8. Of course, underlying this aggregate picture are important regional differences. The growth in Asia's total debt, for example, is a reflection of the dynamic economic situation of the region. With rapid growth of output and exports, the debt indicators for the region have been relatively stable and are the lowest of all the developing country regions despite the relatively rapid growth in borrowing. Latin America, on the other hand, has been reducing its external debt-to-GNP ratio mainly through reduction of debt levels and only slowly undertaking new borrowing. In 1992, Latin America's ratio fell to the average of all the developing countries and was just over a half of the peak reached in 1987. Latin America's ratio of external debt to exports has also come down from its peak, by a third, but the level is still high, remaining at just below twice the level for all the developing countries. As for the ratio of debt service to exports, the peak was achieved in 1982, when the burden of the debt service caused the outbreak of the debt crisis. The rate has since come down by about 40 per cent as international interest rates fell and export earnings grew. However, the region's debt-servicing ratio of 30 per cent is still the highest among the geographical groups and twice the average for all developing countries.

9. Consideration of debt indicators highlights the difficulties faced by African countries, in particular in the sub-Saharan region. For the latter, both the debt-to-GNP ratio and the debt-to-export ratio are almost three times the average for all developing countries. For the capital-importing developing countries of Africa as a whole, total debt is now approximately as much as the value of all economic activity that takes place in a year. Ten years earlier it was half the value of production.

10. The problem of the sub-Saharan region per se is most vividly captured by the ratio of debt to exports, which continued to grow long after the comparable ratios in other regions began a downward trend. This was mainly owing to the region's dependence on primary commodity exports whose prices have been declining, as has the region's market share, owing to reduced competitiveness in some cases. The debt-to-export ratio was also pushed up by the continued inflow of foreign credits, albeit mainly on concessional terms. The debt-to-export ratio grew by over 60 per cent in 10 years and stood at 363 per cent in 1992, comparable to the peak experienced by Latin America and even Africa as a whole in the mid-1980s. The ratio of debt service to exports, however, has declined for sub-Saharan Africa. Partly this reflects the increasing share of concessional financing in the total, as access to several forms of non-concessional credit has been curtailed. But it is also attributable to the non-payment of unsustainably high debt-servicing obligations and is manifested in the accumulation of arrears.

Figure 1. Debt indicators for capital-importing developing countries, 1982, 1987 and 1992

(Percentage)



Source: United Nations, *World Economic Survey, 1993,* table A.36.

B. Debt restructuring

11. Since the debt crisis erupted more than a decade ago, the international community has sought to alleviate the immediate debt-servicing burden of countries in debt crisis and reduce the "debt overhang" that impeded a return to normal access to international finance. International policy in this regard has evolved considerably, as previous reports of the Secretary-General on debt have described. 4/ Several developments in the treatment of the three main categories of developing country debt since the last report, however, are noteworthy.

1. Commercial bank debt

12. One more country, Argentina, completed a debt agreement with its commercial bank creditors in the framework of the Brady Plan, named after the former Secretary of the Treasury of the United States of America. 5/ To date, seven countries have completed their negotiations: Argentina, Costa Rica, Mexico, Nigeria, the Philippines, Uruguay and Venezuela (the Philippine agreement was negotiated in two stages). Another large debtor, Brazil, is reportedly near completion of its agreement and the same basic approach has now come to be used in the negotiations on the commercial bank debt of other countries, such as the Dominican Republic and Jordan. 6/ For the middle income countries, in other words, the Brady Plan mechanism seems to have provided a practical framework for reduction of the debt and debt service owed to commercial banks. This notwithstanding, there is considerable unfinished business, as many countries have yet to complete negotiations with their bank creditors.

13. The international debt strategy has been effective as a model for bringing together four concerned parties: debtor countries, commercial banks, multilateral financial institutions and creditor Governments. Each party is assigned a clear role. Debtor countries tackle adjustment programmes, in support of which the multilateral financial institutions, mainly IMF and the World Bank, provide external funding. Commercial banks, for their part, agree to provide debt and debt-service reduction (DDSR), although sometimes individual banks extend new loans instead of reducing the debtor's obligations. Creditor Governments offer assistance through Paris Club restructuring of debt owed to them and by extending export credits. They can also co-finance DDSR operations, although Japan has been the only creditor Government to have done so to date.

14. Under this approach, each case is dealt with separately, depending on the situation faced by debtor countries and creditor banks. Generally speaking, banks choose from menus that have employed three main categories of options (not all are necessarily available in each case): debt reduction, debt-service reduction and new loans. Debt reduction can involve buy-backs at discounts or swaps of debt for bonds with a lower face value than the original loans (discount bonds). In both cases, the discounts largely reflect the market value of the debt at the time of negotiation, as indicated by the discount prevailing in the secondary market for such debt. Debt-service reduction, normally in the form of interest-reduction bonds, has been offered in three ways. The first is below-market fixed-rate bonds. The second is so-called "step-down/step-up" arrangements, where a very low interest rate is paid in the first year, but it gradually increases in a pre-arranged schedule. The third is temporary

interest-reduction bonds, where interest rates start from a very low level and rise over several years, followed by payment of a variable interest rate calculated as a floating international base rate plus a fixed margin. Finally, new loans (called the "new-money" option) can be offered with or without conversion bonds.

15. The discount bonds and par bonds were generally made more attractive to the creditors with the purchase by the debtor of collateral in the form of zero-coupon United States Treasury securities that would mature on the same day as the debtor-country bond (equivalent securities from other countries could be used to cover non-dollar bonds).

16. Additional international measures were needed, however, to assist low-income countries that, for example, could not afford to purchase such enhancements of their bonds. Thus, drawing on an earlier experience of Bolivia, the World Bank established a Debt Reduction Facility for low-income countries in 1989, set to last until June 1992, to which the Bank contributed $100 million. 7/ However, the initial utilization of the Facility was slow owing to difficulties faced by debtor countries in pursuing adjustment programmes and in concluding negotiations with commercial banks. By March 1992, when the life of the Facility was extended through June 1994, only two countries had carried out buy-back operations (Niger in March 1991 and Mozambique in December 1991). However, the Facility was broadened at the time of the extension, to cover for example, consultation fees to prepare for the debt reduction operations and to cover short-term debt. Since then, Bolivia, Guyana and Uganda have made debt reduction arrangements and Nicaragua, São Tomé and Principe, Sierra Leone and Zambia, as well as Albania, began preparing for buy-back operations under the Facility. 8/

17. Outside these multilaterally supported negotiation schemes, debt conversions have also taken place through many forms of swaps mainly of debt for equity in a local enterprise or on a smaller scale for local government commitments to environmental or other expenditures. Debtor country governments have also bought back their debt on the secondary market. In 1992, Argentina was the main participant in debt-equity swaps, as part of its privatization scheme. Market buy-backs continued at a strong pace, with an estimated $8 billion concluded in 1992, of which $7 billion were accounted for by Mexico. 9/

2. Bilateral official debt

18. The Paris Club, the major forum for restructuring debt owed to official bilateral creditors, takes a different approach than is used by the bank advisory committees (also called the "London Club") which renegotiate the debt owed to commercial banks. The latter negotiate a menu of options for creditor banks on a country-by-country basis. The Paris Club instead first agrees on the outlines of standard treatments of debt for different groups of countries. It then decides which treatment to apply to each specific country that requests assistance. Currently, there are three different sets of rescheduling terms adopted by the Paris Club. Accordingly, the debtor countries are classified into three categories: (a) the poorest and most indebted countries; (b) heavily-indebted, lower-middle-income countries; and (c) all others. The

first group of countries is eligible for the most concessional treatment, known as "enhanced Toronto terms". These are the only terms offered by the Paris Club that provide outright debt reduction. The terms offered to the second group of countries are called "Houston terms" and the standard Paris Club terms are applied to all other countries.

19. With the recognition of the unremitting difficulties faced by the low-income, heavily indebted countries, the Paris Club adopted the enhanced Toronto terms in December 1991. As of June 1993, 17 countries have benefited from the terms, under which debt-servicing obligations falling due over 15 to 18 months may be restructured, although those countries having a programme in force under one of the longer-run facilities of IMF have been granted a longer "consolidation period" of 24 to 35 months.

20. Two main options are offered for the treatment of non-concessional debt, both of which reduce the net present value of the debt by half. 10/ Under one option, creditors write off 50 per cent of the eligible debt over a certain period and reschedule the rest at market rates, with a repayment period of 23 years including a grace period of six years. The other option lets creditors restructure the debt at concessional interest rates so that the net present value of the debt-servicing payments due on the debt will be reduced by half. The payment schedule of the latter option is 23 years without a grace period. However, certain creditors have not been authorized by their legislatures to adopt debt cancellation other than for official development assistance (ODA) loans, which had already been extended on a concessional basis. The terms, therefore, included a reservation for those countries to choose a treatment that was also available under the previous best terms for low-income countries (the Toronto terms). This option restructures the debt servicing due during the consolidation period at market rates, but reschedules it over 25 years with a 14-year grace period. ODA debt is rescheduled over 30 years, with no principal due for 12 years.

21. In addition, the standard agreement under the enhanced Toronto terms has a good-will clause which gives a commitment to consider further debt relief after the initial consolidation period has passed. It also contains a commitment to consider "the matter of the stock of debt" at the end of three or four years (i.e., treating in one negotiation all the future debt servicing on all the debt that was outstanding when the country first came to the Paris Club for assistance and its "cut-off date" was fixed).

22. The Houston terms were proposed at a summit meeting of the seven major industrialized countries held in Houston, Texas, United States of America, in 1990. These terms treat the debt owed by lower-middle income countries and do not involve any write-off of debt or reduction in net present value of debt servicing. The terms reschedule ODA loans over 20 years with a grace period of 10 years. Export credits and non-concessional official loans can be rescheduled over 15 years including a grace period of up to eight years. In addition, the terms include provisions for various debt conversions, which are negotiated in bilateral meetings in a voluntary manner. Up to 10 per cent of non-ODA claims or $10 million (whichever is higher) is eligible for debt conversion. ODA loans and certain other intergovernmental debt may be converted without a limit.

23. The standard Paris Club terms that are applied to all other countries take the debt servicing that falls due on the eligible debt during the consolidation period and reschedule it over 10 years with a grace period of five years on principal payments. Interest payments are expected to continue without a break.

24. A major concern in the international community is whether the current menu of Paris Club treatments is adequate. One proposal that has received considerable support - and may have originally encouraged the Paris Club to adopt the enhanced Toronto terms - was made by the Government of the United Kingdom of Great Britain and Northern Ireland. It proposed a more concessional treatment at a meeting of Commonwealth Finance Ministers in Trinidad and Tobago in 1990, hence the name "Trinidad terms". Trinidad terms would cancel two thirds of the entire stock of eligible debt. The remainder would be rescheduled at market rates over 25 years with a five-year grace period. The summit meeting of the seven major industrialized countries held in Tokyo in July of this year could not reach agreement on the implementation of these terms. However, the Heads of State and Government urged the Paris Club to consider extending further debt relief to the low-income heavily indebted countries, noting, in particular, the matter of the stock of debt.

3. Multilateral debt

25. The debt owed to multilateral financial institutions is the only category of developing-country debt that has no formal framework of restructuring. Indeed, any rescheduling of debt-servicing obligations is expressly forbidden. Some countries became unable to make their payments and have accumulated arrears to the institutions, particularly to IMF. As at the end of January 1993, $4.6 billion in debt-service obligations owed to the Fund by 10 countries were overdue six months or more. 11/ Since then, a considerable amount of IMF arrears was paid, as was also the case for arrears owed to the World Bank. After earlier reductions, all remaining arrears to the Inter-American Development Bank were cleared in 1992, but the amount of arrears to the African Development Bank almost doubled in 1992 to $119 million.

26. Before IMF adopted its "rights accumulation" approach, those countries that accumulated arrears to the Fund or other multilateral institutions were basically left without a set of standardized procedure to help correct their situation. Economic adjustment programmes arranged with IMF had become a fairly general prerequisite to any form of external financial assistance from multilateral institutions or debt restructuring, be it with the Paris Club or commercial banks; but IMF was formally prevented from arranging such a programme as long as the country had significant overdue obligations.

27. Under the IMF mechanism, adopted in March 1990, the Fund can undertake "intensified collaboration" with the countries in arrears in order to establish what is, in effect, a shadow IMF adjustment programme. The Fund monitors the programme and as the country establishes a track record of performance on adjustment, it accumulates "rights" to make a drawing at the end of the programme. Bilateral creditors arrange balance-of-payments support in the meantime, which helps prevent the arrears to IMF from increasing. Bilateral creditors may also extend a short-term credit at the end of the programme to repay the outstanding arrears. That credit is in turn repaid out of the

proceeds of the IMF loan which the country receives as a result of its having accumulated rights to a Fund drawing. Similarly, bilateral short-term credit arrangements are used to clear arrears with other multilateral lenders.

28. For example, in March 1993 Peru returned to active-member status at IMF, when a short-term loan of $860 million from Japan and the United States financed the repayment of IMF arrears, after which the Fund approved a $1.4 billion loan to be disbursed over three years. In a comparable operation, Peru cleared about $900 million in arrears to the World Bank, after which the Bank activated $1 billion in credits (arrears to the Inter-American Development Bank were cleared in 1991).

II. CURRENT ISSUES IN INTERNATIONAL DEBT POLICY

29. The debt crisis erupted in many of the developing countries when foreign private creditors ceased to finance balance-of-payments deficits. In those cases, the end of the debt crisis might be said to arrive when the confidence of foreign creditors was restored and they again began to extend credit. In other debt-crisis countries, most foreign credit was supplied by official creditors and the crisis was less a sudden loss of foreign confidence and liquidity than a build-up of debt-servicing obligations to levels that became incompatible with developments in foreign exchange earnings and the cost of necessary imports.

30. For the most part, countries in the latter category of debt-crisis, concentrated in Africa, remain mired in debt problems. However, several of the countries in the former category have returned to the financial markets and in this sense their debt situation is no longer appropriately characterized as one of crisis proportions. This is not to say that their economic growth and development trends have rebounded to acceptable minimums or that their debt-servicing burdens are not still high. It is only to say that their debt difficulties as such are perceived as less salient issues economically and politically than they were before. This may change if the debtor countries encounter additional obstacles to expansion of their exports to industrialized countries, or if, say, terms of trade deteriorated sharply once again, or if there is a reversal in the recent spate of capital inflows. 12/

A. The overall policy environment

31. A permanent solution to the developing country debt crisis, in other words, embodies progress in several broad policy dimensions. One is enhancing the system of international trade and national practice in setting trade policy. A certain degree of volatility and uncertainty is natural in international trade, but beyond that developing countries - indeed, all countries - seek confidence that trading regimes will not suddenly be adversely altered and that key prices will fluctuate within normal ranges. This requires well functioning international institutions and arrangements.

32. The pursuit of confidence-building strategies of economic adjustment in developing and developed countries is also required. In the former countries, the pay-off includes higher domestic saving and investment rates, as well as attraction of investment-increasing long-term capital inflows. In the latter

countries, the pay-off includes gathering more of the potential dynamic benefits of international trade, as well as enhancing the stability of international financial flows and key-currency exchange rates.

33. Confidence in domestic economies grows out of the pursuit of appropriate national policy packages. These entail sound macroeconomic management, micro-economic policies that increase the responsiveness of economic sectors, and policies to equitably share the burdens and benefits of adjustment, in particular, to protect social and political stability through adequate social safety nets for the vulnerable groups most adversely affected by economic reform programmes. 13/

34. A further dimension of international policy that bears on resolving the developing country debt problem is ensuring adequate supplies of appropriate official financial flows to support efforts of developing countries to increase investment, particularly for diversification. Over time, private finance - whether in the form of direct investment, international portfolio investment, international bank lending or bonds - takes on increasing proportions of the international transfers of financial resources for development, as economies grow and are seen to be increasingly attractive placements for funds. Official finance, especially concessional finance - i.e., ODA - remains especially important for reducing external constraints and facilitating the reform process in low-income countries. Yet, recent trends and the short-term outlook for aid flows, whether through bilateral or multilateral channels, have not been encouraging. 14/ For the prospects of low-income, heavily indebted developing countries, this is a particularly worrisome concern.

B. A focus on the Paris Club

35. The international community has marshalled considerable effort for several years to ameliorate the economic and financial situation of low-income, heavily indebted countries and other countries, particularly in Africa. But economic and social conditions in those countries have generally not improved as hoped. The trends in the debt indicators of the sub-Saharan region, as noted above, are a potent measure of the financial difficulty. For many countries, the greater probability is that the existing debt-servicing obligations will not be met, despite several rounds of debt-rescheduling in the Paris Club, the London Club or ad hoc arrangements.

36. This view is frequently expressed in private financial circles, in effect, where the secondary market prices for the commercial bank debt of some countries are extremely low. In June 1993, for example, only 7 cents per dollar of face value was bid for the debt of Côte d'Ivoire, while bids for the Sudan's debt were 1 cent per dollar and for Zaire's debt the bids were 9 cents. Admittedly, these were extreme cases, as bids on the debt of Senegal were 38 cents per dollar of debt, for Nigeria 45 cents and Morocco 64 cents. 15/ But that is the point: however difficult the financial situations in the second set of countries, and they are substantial, the difficulties in the former group are of a deeper order of magnitude.

37. The market's appraisal suggests that the prospect is low that many countries will be able to mobilize adequate foreign exchange over time through

export earnings and financial inflows to purchase necessary imports and leave enough over to service first their multilateral debt and then the commercial bank and Paris Club debt.

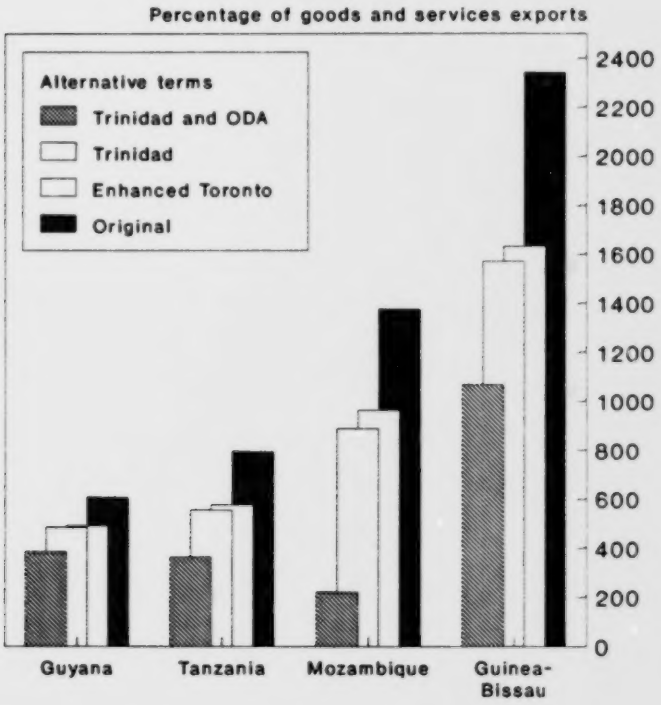
38. There is no secondary market for debt owed to official creditors, but a strict assessment of repayment prospects on this debt would in principle be of the same nature as for commercial bank debt. Indeed, the calls for greater debt relief through the Paris Club, in particular the Trinidad terms proposal noted above for low-income countries, indirectly allude to this point, as does a unilateral policy measure announced by the Government of France in October 1992 for four middle-income countries: Cameroon, the Congo, Côte d'Ivoire and Gabon. In that initiative, France offered to set up a debt-conversion fund of 4 billion francs that would, in effect, recycle debt-servicing payments to development projects in the participating countries.

39. The scope of the problem can be roughly quantified. The UNCTAD secretariat calculated that for half of the potential beneficiaries, the Trinidad terms would reduce the debt-servicing ratio to 20 per cent, a benchmark level that roughly indicates having the capacity to pay. For the other half of potential beneficiaries, however, additional measures to reduce debt servicing would be required. 16/

40. The World Bank made a comparable analysis and took it one step further in evaluating the additional impact of a complete write-off of bilateral concessional debt. In that study, the net present value of debt servicing was examined under different debt-restructuring options. For the low-income countries that actively participate in the Bank's Special Programme for Africa (SPA), the net present value of the debt servicing on all outstanding debt as of the end of 1991 based on scheduled payments was $42 billion. If the Toronto terms had instead been applied to all countries in the group (even though not all SPA countries have debt-servicing crises), the present value of the debt service would only be reduced to $36 billion. The enhanced Toronto terms would reduce the total by an additional $2 billion. Even applying the Trinidad terms, the total net present value would be $32 billion, although if all outstanding bilateral concessional debt were forgiven as well, the total would drop to $25 billion. At this level of aggregation, the latter would roughly meet a rule-of-thumb for avoidance of debt-servicing crises, namely, a ratio of the present value of total debt service to exports of about 200 per cent. 17/

41. It is important to note, however, that the aggregate is an average of countries and that many would remain well above the 200 per cent benchmark even if all their bilateral ODA debt were forgiven. Indeed, out of a sample of 26 active SPA countries, five lower middle-income African countries, plus Guyana and Honduras (or a total sample of 33 countries), 14 were estimated to have ratios of net present value of debt to exports above 250 per cent under the Trinidad terms for restructuring debt. Although forgiving concessional bilateral debt would significantly reduce the ratio for most of the countries, in only two cases would the ratio drop below 250 per cent. Figure 2 illustrates the range of effects of the three different options for selected countries.

Figure 2. Impact of alternative rescheduling terms on the net present value of the debt of selected countries



Source: World Bank, *World Debt Tables 1992-93*, vol. 1, pp. 8-9.

42. To adopt such proposals for treating bilateral official debt as are discussed here requires that creditor Governments formally acknowledge what private sector creditors already have acknowledged, namely, that in many cases the debtors do not have and are not likely to regain the capacity to honour their obligations. Commercial banks were forced by bank regulators and their own shareholders to treat the debt as "value impaired". Government creditors have not been under the same pressure. Indeed, it is often said that creditor Governments have difficulty granting major debt forgiveness because of its budgetary consequences. The reality is that only the accounting consequences would be significant; the cash-flow consequences would be small or negligible.

C. Difficulties in servicing multilateral debt

43. From the early days of the developing country debt crisis, official and private creditors have sought to restructure debt in collective creditor forums: the Paris Club for official bilateral creditors and bank advisory committees for bank creditors. One key reason - and certainly not the only one - is that neither banks nor export credit agencies wished to take a disproportionate loss and give a financial advantage to their competitors. There was no competitive pressure and little focus on how the losses in debt relief operations were spread across different types of creditors. Thus, the multilateral development institutions and IMF have maintained their "preferred creditor" status and remained exempt from debt restructuring. But if even the most generous terms of private and official debt relief that have been seriously contemplated were to leave a significant number of countries with unsustainable debt-servicing burdens, as suggested in paragraphs 39 and 40 above, attention would necessarily be drawn to the servicing of debt owed to multilateral institutions.

44. The current international strategy for heavily indebted countries is to help reduce the burden of private and bilateral debt servicing, stimulate the transfer to these countries of non-debt-creating flows, enhance the ability to increase and mobilize domestic resources for investment and extend significant new multilateral credits. One result is that an increasing share of the debt of countries in difficulty is owed to multilateral creditors and is not subject to restructuring. 18/ When the affected countries, in following internationally supported adjustment programmes, find difficulty in servicing debt to multilaterals, one possibility is extension of new credit. If the need for the extra financing is owing not only to a short-run shortage of liquidity but also to a lack of solvency, there is a problem. New lending only postpones the day of reckoning.

45. Currently, there are only very limited means to alter the cash flow of multilateral debt servicing. One is to refinance non-concessional loans indirectly with new concessional balance-of-payments financing. This option is only available, however, to countries that once borrowed from the regular facilities of the multilateral institutions but whose economic deterioration has since made them eligible for concessional lending.

46. In addition, for this particular group of countries, the World Bank has developed a special programme to reduce the interest cost on outstanding Bank loans. The programme, sometimes referred to as the "fifth dimension", is operated by the International Development Association (IDA), the concessional

lending arm of the Bank, and takes the form of supplemental IDA adjustment credits. In other words, low-income countries that are undertaking adjustment programmes that are being supported by IDA lending can receive additional IDA credits in proportion to their interest obligations on outstanding non-concessional World Bank debt. Since IDA credits are highly concessional, this effectively subsidizes interest payments to the Bank. The operation is important as it provides a mechanism to reduce the net present value of debt owed to the World Bank Group and is potentially available to all countries that have outstanding World Bank debt and now fall into the category of countries that only borrow from the Bank using IDA resources. Also, it does not formally violate the policy prohibiting World Bank debt relief.

47. The only other approach to the problem under current practices is an ad hoc mobilization of a group of bilateral donors to assist a country that becomes unable to service its multilateral debt and builds up arrears. The donors might pay part of the interest cost or principal on loans and provide the funds to repay the arrears. The approach helps reduce the present value of the multilateral debt and has been important for the countries receiving the assistance. While it preserves the integrity of the no-rescheduling policy of the institutions, this approach reduces their multilateral character as the debtor assumes new obligations with a limited number of countries.

48. The economic and financial argument against direct debt relief by multilateral creditors is that these institutions rely for funds for the most part on the willingness of other creditors to place resources with them. In the case of IMF, the monetary authorities of member States consider their IMF position as an official reserve asset. In the case of the development banks, the international private sector purchases bonds issued by the institutions, and they are considered virtually risk-free. A relevant question, then, is whether the financial condition of the institutions could be seen by their creditors to have weakened if they were to introduce a formal mechanism for debt restructuring in exceptional cases.

49. This is an issue already raised by some government officials from debtor countries. On this point, two observations might be pertinent. First, arrears to the multilateral institutions became a fact of life almost a decade ago, as several countries found that they could not remain current no matter how strong their obligations to the institutions. The institutions were thus required to make formal arrangements for member States to share the financial consequences of arrears and to account for them in the financial statements of the institutions. These arrears are now being reduced significantly, largely through arrangements that are financially supported by groups of bilateral donors, as noted above. However, there is no reason to believe that an arrears situation might not again arise. Secondly, the financial markets closely observe the multilateral banks. The advisory and bond-rating services, in particular, are fully aware of the state of the loan portfolios of the institutions. Thus, when restorative measures are required, financial markets have no difficulty in perceiving that debt-servicing obligations have been restructured, regardless of the mechanism by which they are undertaken. In the view of some analysts, therefore, it appears to be a matter of policy choice whether or not to undertake restructuring directly and in a fully multilateral spirit.

III. CONCLUSION

50. The goal of the international community is to see the developing countries overcome their debt crises and restart the process of development where the debt crisis has hobbled it. There is already wide agreement on some of the policy issues outlined in the preceding section of this report, although governments may require encouragement to implement them fully. Others are near consensus, while still others are controversial.

51. There seems to be broad agreement among Governments on the policies for an appropriate economic and financial environment, as outlined in section II.A above. Political exigencies may have slowed implementation in some cases, and these need to be overcome. As to commercial bank debt, the current approaches to debt restructuring appear to have been effective in practice, and they seem to be available to increasing numbers of debtor countries. However, the negotiation process is often quite protracted and the urgency of reaching an agreement does not always seem sufficiently appreciated.

52. There is almost a common view on the required next step in the generally agreed necessity to further ease the terms of debt relief in the Paris Club for many countries. Adopting the Trinidad terms would assist the low-income countries. For middle-income countries - in marked contrast to the case of commercial bank debt - the Paris Club currently offers no options that reduce the net present value of debt obligations. 19/ Regarding official development assistance, the United Nations provided a forum in which the appropriate easing of the terms of ODA credits was agreed 15 years ago, and considerable progress has been made in this area since then. 20/ As UNCTAD and World Bank calculations noted above indicate, however, for some countries, the maximum relief under all these programmes may not be sufficient. Further concessions of private and bilateral creditors or a more systematic approach to multilateral debt servicing may be warranted.

53. Finally, it is widely appreciated that solving the debt problem of the developing countries would not ipso facto solve external financial constraints, much less, their development problem. Restructuring debt so as to remove the debt overhang needs to be seen as part of a package of measures leading to a sustainable external payments situation with adequate economic growth. Even the countries that are furthest along in working their way out of their debt crisis have not yet fully reached that goal. In many cases their recovery remains fragile and will have to be closely watched. Many other countries remain even further behind and are not yet out of the debt crisis. Intensified international cooperation is thus still warranted on two fronts: (a) assisting countries still mired in the debt crisis; and (b) helping countries restore adequate economic growth.

Notes

1/ The debt difficulties of eastern European planned economies began earlier, in the first quarter of 1981 when Poland was unable to meet its debt-servicing obligations and private lending to the entire region began to be reassessed. The debt situation of these economies then became a focus of international concern, as has that of the successor transition economies of eastern Europe and the former Soviet Union (see World Economic Survey, 1993, United Nations publication, Sales No. E.93.II.C.1), pp. 115-123.

2/ Estimates of debt and debt indicators and definitions of country groupings are those of World Economic Survey, 1993.

3/ Sub-saharan Africa is defined in this report to exclude Nigeria because the large level of its debt would overwhelm the statistics of the smaller African countries. Nigeria's debt outstanding was lower at the end of 1992 than in 1989, owing to its debt-and-debt-service-reduction agreement with commercial banks in January 1992.

4/ See A/41/643, A/42/523, A/43/647, A/44/628, A/45/656, A/46/415 and A/47/396.

5/ The mechanism under which the Plan operates was analysed in the 1992 report (A/47/396), pp. 15-21.

6/ The terms of the general agreement reached by the two countries with their commercial banks this year are given in World Bank, Financial Flows to Developing Countries: Quarterly Review, July 1993, pp. 18-19.

7/ Similarly, the Inter-American Development Bank established a Debt Reduction Facility in 1991.

8/ World Bank, Financial Flows, p. 19.

9/ World Bank, World Debt Tables, 1992-93, vol. 1 (December 1992), p. 25.

10/ The net present value is determined in effect by considering the future flow of interest and principal payments and figuring out what a bond that yielded an equivalent cash flow would be worth today.

11/ IMF, Financial Statements, quarter ended 31 January 1993.

12/ On the latter, see World Economic Survey, 1993, pp. 92-95.

13/ For a fuller discussion, see the report of the Secretary-General on economic stabilization programmes in developing countries, to be submitted to the Assembly at its current session (A/48/380).

14/ See the report of the Secretary-General on sources of financing for development, to be submitted to the Assembly at its current session (A/48/367).

15/ Quotations are monthly averages of daily and weekly bids, as provided to the United Nations by two New York investment houses that operate in the market, Merrill Lynch and Salomon Brothers.

16/ See UNCTAD, Trade and Development Report, 1992 (United Nations publication, Sales No. E.92.II.D.7), pp. 61-62.

17/ Based on data contained in a World Bank presentation to United Nations Panel of High-level Personalities on African Development, Rome, 17-18 April 1993.

18/ In Latin America as a whole, multilateral debt rose from 6 per cent of the total in 1982 to 17 per cent in 1991, while in the sub-Saharan grouping of countries it rose from 25 per cent to 30 per cent (as per World Economic Survey, 1993, table A.35).

19/ However, arrangements that build to a 50 per cent reduction of eligible debt were made for Egypt and Poland in 1991 under special circumstances in each case, underlining that the Paris Club, as an intergovernmental body, is indeed a political institution.

20/ The original agreement was contained in Trade and Development Board resolution 165 (S-IX) of March 1978, in which developed donor countries agreed to seek to adopt measures to ease the terms of outstanding ODA debt. Originally, this meant revising the terms of outstanding loans to meet the easier terms subsequently offered. Over time, ODA was increasingly provided in grant form and outstanding ODA debt was forgiven. According to information reported to UNCTAD and the World Bank, over $15 billion of ODA loans were written off by developed donor countries as of 1991.